

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



**FINANCIAL EXAMINATION
OF**

**Vision Service Plan
Seattle, Washington**

**NAIC CODE 47317
DECEMBER 31, 2005**

**Order No. G 06-59
Vision Service Plan
Exhibit A**

SALUTATION

Seattle, Washington
November 1, 2006

The Honorable Mike Kreidler, Commissioner
Washington State Office of the Insurance Commissioner (OIC)
Insurance Building – Capitol Campus
302 – 14th Avenue SW
Olympia, WA 98504

Dear Commissioner Kreidler:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.44.145 and RCW 48.03.010, an examination was made of the corporate affairs and financial records of

Vision Service Plan


of

Seattle, Washington

hereinafter referred to as "VSP" or the "Company." The statutory home office is located at One Union Square Building, 600 University Street, Suite 2004, Seattle, Washington 98101-3114. The examination was conducted at the main administrative office located at 3333 Quality Drive, Rancho Cordova, California 95670.

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Vision Service Plan of Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2005.



Patrick H. McNaughton
Chief Examiner

11-1-06
Date

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SCOPE OF THE EXAMINATION

This examination covers the period January 1, 2001 through December 31, 2005 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administration Code (WAC), Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2005 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the NAIC Accounting Practices and Procedures Manual (AP&P).

There were no examination instructions.

COMMENTS AND RECOMMENDATIONS

VSP of Washington does not have its own employees. Vision Service Plan of California (VSPCA) is the parent and performs services for VSP pursuant to an Administration and Marketing Agreement. Information systems facilities and services are provided by VSPCA for all affiliated insurers (VSP Group).

1. Internal Audit Function

The NAIC recommends as a good business practice that insurance companies have an internal audit department. Additionally, the internal audit department should include information system (IS) auditors performing periodic tests of the IS system. The VSP Group does not have an internal audit department.

It is recommended that the VSP Group implement an internal audit department performing periodic internal audits and tests of the IS systems. The internal audit

department should report to the Board of Directors or an appropriate committee of the Board of Directors.

2. Access to Computer Facility

Individuals who are not members of the IS Department and do not have specific job functions within the computer facility have access to the computer facility. Individuals not having specific job functions within the computer facility should not have access rights.

It is recommended that access to the computer facility without an escort be restricted only to those individuals who have specific job functions within the computer facility.

3. Storage of Check Stock

The check stock used for the payment of claims is kept on open shelving in the IS Facility Print Room. There are seventy five individuals with access to the room and check stock, but only a limited number of these individuals have a business reason for access to the check stock.

It is recommended that access to the claim check stock be restricted to a limited number of appropriate individuals in a secured and locked environment.

4. Inventory of IS Equipment

The inventory of the equipment used within the IS Department is maintained and controlled by an employee within the IS Department. For proper separation of duties and controls, the inventory of IS equipment should be maintained by someone outside of the IS Department.

It is recommended that the inventory of IS equipment be maintained and under the control of someone outside of the IS Department.

5. Manager Review of Access Rights and Security Levels

Managers for the operational departments do not review the current access rights of their staff members to ensure the access rights and security levels are commensurate with their job responsibilities.

It is recommended that managers review the access rights and security levels of their staff on an annual basis to ensure the access rights and security levels are commensurate with job responsibilities.

6. Intrusion Detection System

The VSP Group currently deploys several point solution tools to detect intrusions into its network. These tools are used periodically, on an ad hoc basis, to detect intrusions, usually in a forensic mode after the intrusion has occurred.

It is recommended that the VSP Group take a more proactive/preventive approach towards securing its IS system and protecting patient records.

COMPANY PROFILE

Company History

Vision Service Plan is a state of Washington domiciled non-profit non-stock corporation organized pursuant to Chapter 24.03 RCW and is registered as a limited health care service contractor pursuant to Chapter 48.44 RCW. The Company is engaged in the business of providing vision care services in the state of Washington.

The Company was first incorporated as Washington Vision Services, Inc., on March 6, 1959. The corporate name was amended to Western Vision Services (WVS) on June 7, 1968. On January 10, 1990, Vision Service Plan of California entered into an agreement for a change of member control whereby VSPCA became the sole voting member of WVS. The name of the Company was again changed on April 11, 1990, to its current name, Vision Service Plan.

Capitalization

Every limited health care service contractor must have and maintain a minimum net worth of \$300,000 pursuant to RCW 48.44.035(3). The Company maintains a statutory reserve of membership contributions in the amount of \$300,000 and unassigned funds in the amount of \$44,908,491.

Territory and Plan of Operation

The Company is authorized to write vision care programs to subscriber groups on both a risk and a self-funded basis in the state of Washington. Subscriber groups that purchase risk plans pay an agreed upon monthly premium based upon total number of eligible members. Subscriber groups that elect self-funded programs reimburse the Company for benefits paid and pay an administrative fee.

The Company increases business by adding new groups or expanding existing groups within the scope of vision services.

Acquisitions, Mergers, Disposals, Dissolutions, Purchases, and Sales

There are no plans for acquisitions, mergers, disposals, dissolutions, purchases or sales.

Growth of Company

The following reflects the growth of the Company based on the filed NAIC Annual Statements for the years ending December 31:

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Assets, Liabilities, Capital and Surplus:					
Admitted Assets	\$30,849,927	\$34,174,883	\$35,934,809	\$42,443,192	\$47,233,611
Liabilities	3,715,948	2,681,039	4,222,716	3,988,741	2,025,120
Capital and Surplus	<u>\$27,133,979</u>	<u>\$31,493,844</u>	<u>\$31,712,093</u>	<u>\$38,454,451</u>	<u>\$45,208,491</u>
Revenue and Expenses:					
Premiums and Risk Revenue	\$26,366,576	\$24,910,043	\$25,487,829	\$21,479,906	\$21,714,085
Net Underwriting Deductions	22,593,096	22,003,855	23,593,527	18,317,071	16,882,156
Underwriting Gain or Loss	3,773,480	2,906,188	1,894,302	3,162,835	4,831,929
Investment and Other Income	791,040	710,475	684,091	627,856	1,143,941
Pre-Tax Income	4,564,520	3,616,663	2,578,393	3,790,691	5,975,870
Taxes Incurred	1,270,000	(1,270,000)	0	0	0
Net Income	<u>\$3,294,520</u>	<u>\$4,886,663</u>	<u>\$2,578,393</u>	<u>\$3,790,691</u>	<u>\$5,975,870</u>

AFFILIATED COMPANIES

Vision Service Plan of California:

VSPCA is a California non-profit non-stock corporation organized in the state of California to market and administer prepaid vision care plan services. VSPCA is wholly controlled by its Board of Directors. VSPCA wholly controls sixteen non-profit non-stock health plans, including VSPWA, doing business in various states throughout the United States. VSPCA wholly owns **Altair Holding Company (CA)** a California holding company and **Vision Service Plan Insurance Company (CT)** a Connecticut stock corporation.

Altair Holding Company (CA):

Altair Holding Company (CA) wholly owns **Altair Eyewear (CA)** a California stock corporation and Vision Service Plan Insurance Company (MO) a Missouri stock corporation.

Altair Eyewear (CA):

Altair Eyewear is a wholly-owned subsidiary of Altair Holding Company which is a private label frame company and VSPCA is the ultimate owner. Frames are sold exclusively to VSPCA affiliate doctors, but are not, limited to VSPCA affiliate policyholders.

Vision Service Plan Insurance Company (CT):

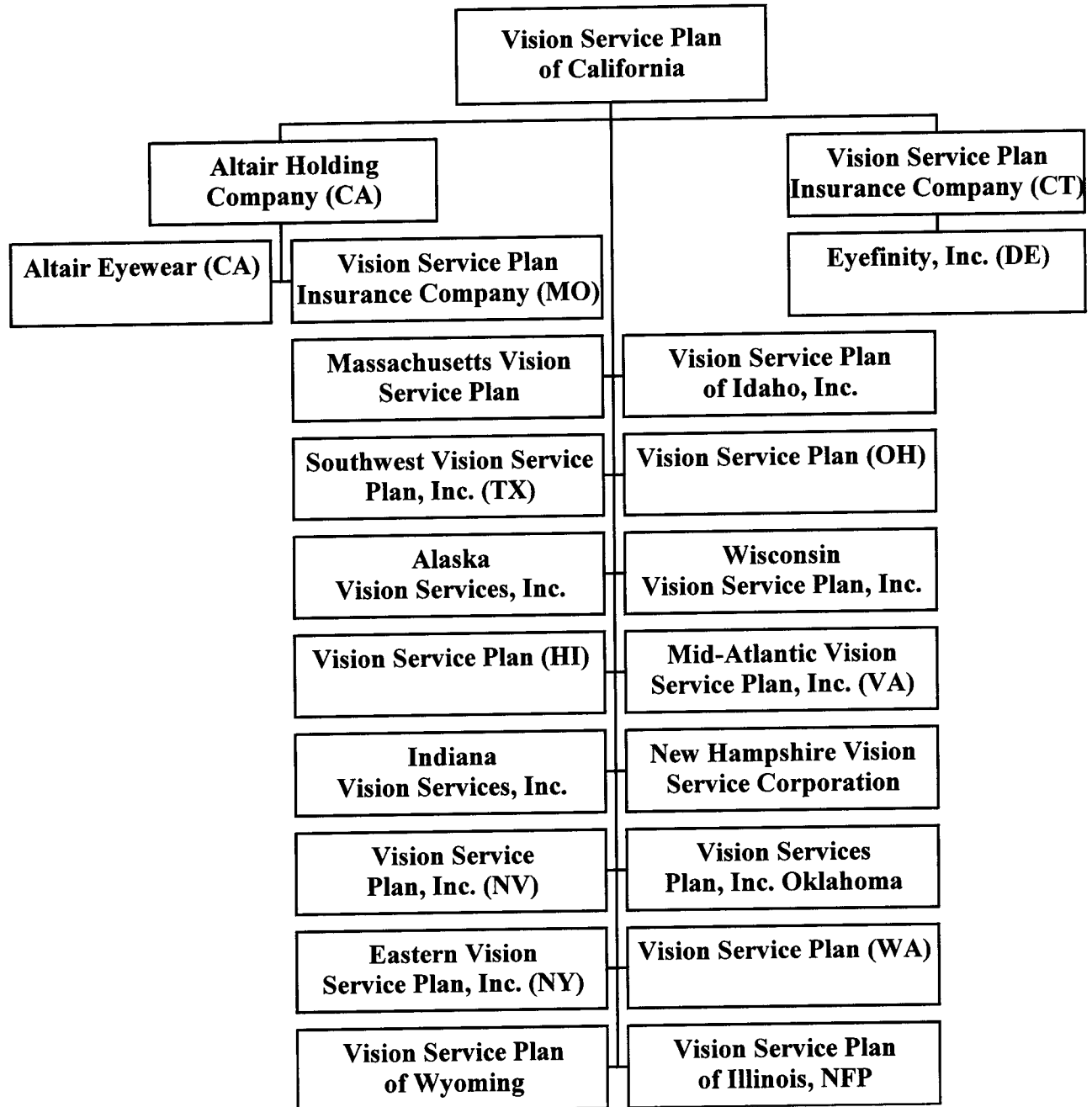
Vision Service Plan Insurance Company (CT) owns a majority of **Eyefinity, Inc. (DE)** a Delaware stock corporation.

Eyefinity, Inc. (DE):

Eyefinity, Inc., is wholly owned by Vision Service Plan Insurance Company of Connecticut which commenced business in June of 2000 as a service-oriented technology company, and VSPCA is the ultimate owner. Eyefinity, Inc., provides a range of services over the internet, from electronic authorization and claim services, to eyewear materials purchasing and website

hosting. This service has enabled VSPCA affiliates to accept over eighty per cent of their claims electronically.

Organizational Chart (members of the VSPCA Holding Company Group)



INTERCOMPANY AGREEMENTS

As a member of an insurance company holding system, certain intercompany agreements and any amendments with effective dates May 7, 2001 and later must be filed with the OIC pursuant to Chapter 48.31C RCW. No exceptions were noted.

As of December 31, 2005, the Company was party to the following agreement:

Administration and Marketing Agreement (AMA):

VSP entered into an Administration and Marketing Agreement with VSPCA on February 10, 1998. VSP paid \$5,340,991 under this agreement for the period ending December 31, 2005. A copy of this agreement has been filed with the OIC.

Tax Allocation Agreement:

There are no consolidated tax allocation agreements with affiliates.

MANAGEMENT AND CONTROL

Ownership

The Company's Articles of Incorporation state that VSPCA is the sole owner of the Company.

Board of Directors (BOD)

Management of the Company is vested in a board of seven directors elected by VSPCA at an annual meeting to serve a three year term. All current terms will expire October 18, 2007.

The following seven individuals were Directors as of December 31, 2005:

Roger J. Valine	President	since March 4, 1991
Gary N. Brooks	Secretary	since March 4, 1991
Patricia Chochran	Treasurer/CFO	since March 4, 1991
L. Donald Price		since March 4, 1991
Richard W. Steere		since January 4, 1993
Walter Grubbs		since January 16, 1995
Cheryl Johnson		since August 20, 2001

Officers

The president, secretary and treasurer are elected by the sole voting member at each annual meeting for a one year term. Officers as of December 31, 2005 were:

Roger J. Valine	President
Gary N. Brooks	Secretary
Patricia Chochran	Treasurer/CFO

Conflict of Interest

The Company has reporting procedures in place to disclose potential conflicts of interest to the chair of the BOD or the president of the Company.

Fidelity Bond and Other Insurance

VSP's insurance coverage includes the following policies:

The Company is a named insured on a financial institution fidelity bond purchased by the parent. An aggregate loss limit of coverage in the amount of \$4,000,000 is provided for all of the affiliated companies insured and the single loss deductible is \$75,000. The minimum amount recommended by the NAIC for the insured companies is \$2,250,000 to \$2,500,000. The aggregate amount of coverage meets the NAIC recommended level for the Company.

The Company is also provided protection against certain property and liability losses as a named insured on several other insurance policies purchased by the parent. Policies in effect at December 31, 2005 provided the following coverages:

- Directors & Officers Liability Insurance - \$10,000,000 policy limit
- Commercial General Liability Insurance - \$2,000,000 policy limit
- Business Automobile Insurance - \$1,000,000 policy limit
- Managed Care Professional Liability Insurance - \$5,000,000 policy limit
- Employment Practices Liability Insurance - \$10,000,000 policy limit

Officers', Employees', and Agents' Welfare and Pension Plans

VSPCA performs services for VSP pursuant to an Administration and Marketing Agreement. VSPCA maintains a defined contribution retirement plan for the group employees along with an employee deferred compensation program. Additionally, employees retiring after meeting specified employment conditions are entitled to post-retirement health, dental, vision and prescription drug benefit coverage. Employee benefit costs are addressed under the Administration and Marketing Agreement.

CORPORATE RECORDS

The Articles of Incorporation, Bylaws, Certificate of Registration and minutes of the BOD and committees were reviewed for the period under examination. No exceptions were noted and all BOD meetings were conducted with a quorum present.

ACTUARIAL REVIEW

An independent consulting actuary with The Kilbourne Company and a member of the American Academy of Actuaries performed a review with regard to VSP loss reserves, actuarial liabilities, and related items as included in the December 31, 2005 NAIC Annual Statement.

OIC examiners reviewed the underlying data supporting the values reported in the 2005 NAIC Annual Statement and found them to be free of material misstatement and included provisions

for all components required in SSAP NO. 55, paragraphs 7 and 8. The examiners have relied upon the consulting actuary's opinion in that the amounts carried in the balance sheet:

- Are in accordance with accepted actuarial standards consistently applied and are fairly stated in accordance with sound actuarial principles,
- are based on actuarial assumptions relevant to contract provisions and appropriate to the purpose for which the statement was prepared,
- meet the requirements of the laws of the state of Washington,
- make a good and sufficient provision for all unpaid claims and other actuarial liabilities of VSP under the terms of its contracts and agreements,
- are computed on the basis of assumptions consistent with those used in computing the corresponding items in the annual statement of the preceding year-end, and
- include appropriate provision for all actuarial items that ought to be established.

REINSURANCE

There were no reinsurance agreements involving the Company for the five year period ended December 31, 2005.

STATUTORY DEPOSITS

The OIC requires the filing of the Underwriting of Indemnity Calculation or Funded Reserve Form pursuant to WAC 284-07-050(8). The calculation as of December 31, 2004, pursuant to WAC 284-44-340, requires a minimum deposit in the amount of \$355,855.

A US Treasury Note including cash reserve funds with a total fair market value in the amount of \$649,250 is being held in a special deposit account by the custodian, Bank of New York. The deposits were confirmed directly with the custodian by the OIC as of the year ended 2005.

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting firm of PricewaterhouseCoopers, LLP. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no exceptions were noted.

The management of the Company is sufficiently knowledgeable of the IS process. Systems development, acquisition and maintenance controls were evaluated to gain assurance that appropriate internal controls are in place. Operations and application controls were reviewed to determine the following: the type of hardware installed, operating systems and proprietary software in use, back up and recovery facilities employed, and the internal controls exercised to

maintain data security. Sufficient internal controls are in place and monitored by the Company, however; the examiners determined during their review that individuals not having any IS function were allowed unescorted access to various IS facility locations, and check stock was stored on open shelving. (See Comments and Recommendations No. 2 and 3)

The Company's IS Department has the ability to recover from an incident or disaster and has documented the procedures in a detailed written disaster recovery plan. The Company also has a formal, written business contingency plan that addresses the continuation of all significant business activities, including financial functions, telecommunication services and data processing services, in the event of a disruption of normal business activities.

SUBSEQUENT EVENTS

There have been no events occurring subsequent to December 31, 2005, which would have a material effect on the financial condition of the Company.

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of Vision Service Plan as of December 31, 2005:

Assets, Liabilities, Capital and Surplus
Statement of Revenue and Expenses
Five Year Surplus Reconciliation

VISION SERVICE PLAN
ASSETS, LIABILITIES, CAPITAL AND SURPLUS
DECEMBER 31, 2005

	<u>BALANCE</u> <u>PER COMPANY</u>	<u>ref.</u>	<u>EXAMINATION</u> <u>ADJUSTMENTS</u>	<u>BALANCE PER</u> <u>EXAMINATION</u>
Assets				
Bonds	\$27,471,924		\$0	\$27,471,924
Cash and short-term investments	14,402,380			14,402,380
Investment income due and accrued	430,203			430,203
Premiums and considerations:				
Uncollected premiums and agents' balances	783,803			783,803
Amounts receivable relating to uninsured plans	3,070,834			3,070,834
Receivables from parent, subsidiaries and affiliates	1,074,467			1,074,467
Total Assets	<u><u>\$47,233,611</u></u>		<u><u>\$0</u></u>	<u><u>\$47,233,611</u></u>
 Liabilities, Capital, and Surplus				
Claims unpaid	\$1,232,863		\$0	\$1,232,863
Unpaid claims adjustment expenses	54,780			54,780
Aggregate health policy reserves	67,027			67,027
Premiums received in advance	40,499			40,499
General expenses due or accrued	172,499			172,499
Liab. for amounts held under uninsured A&H plans	409,140			409,140
Aggregate write-ins for other liabilities:				
Taxes, licenses and fees due or accrued	48,312			48,312
Total Liabilities	<u><u>2,025,120</u></u>		<u><u>0</u></u>	<u><u>2,025,120</u></u>
 Statutory Reserve	300,000			300,000
Unassigned funds (surplus)	44,908,491			44,908,491
Total Capital and Surplus	<u><u>45,208,491</u></u>		<u><u>0</u></u>	<u><u>45,208,491</u></u>
Total Liabilities, Capital and Surplus	<u><u>\$47,233,611</u></u>		<u><u>\$0</u></u>	<u><u>\$47,233,611</u></u>

**VISION SERVICE PLAN
STATEMENT OF REVENUE AND EXPENSES
DECEMBER 31, 2005**

	<u>BALANCE PER COMPANY</u>	<u>ref.</u>	<u>EXAMINATION ADJUSTMENTS</u>	<u>BALANCE PER EXAMINATION</u>
Member months	5,637,789			5,637,789
Net premium income	\$21,027,915		\$0	\$21,027,915
Risk revenue	686,170			686,170
Total revenues	21,714,085		0	21,714,085
<u>Hospital and Medical:</u>				
Other professional services	17,469,631			17,469,631
Subtotal	17,469,631		0	17,469,631
<u>Less:</u>				
Total hospital and medical	17,469,631			17,469,631
Claims adjustment expenses	127,062			127,062
General administrative expenses	217,417			217,417
Increase in reserves for A&H contracts	(931,954)			(931,954)
Total underwriting deductions	16,882,156		0	16,882,156
Net underwriting gain or (loss)	4,831,929		0	4,831,929
Net investment income earned	1,162,119			1,162,119
Net gain or (loss) from agents' or premium balances charged off	(18,178)			(18,178)
Aggregate write-ins for other income or expenses	0			0
Loss on sale of property	0			0
Miscellaneous expense, net				
Net income or (loss) before FIT	5,975,870		0	5,975,870
Net Income (Loss)	\$5,975,870		\$0	\$5,975,870
<u>CAPITAL AND SURPLUS ACCOUNT</u>				
Capital and surplus prior reporting period	\$38,454,451		\$0	\$38,454,451
Net Income (Loss) from above	5,975,870			5,975,870
Change in nonadmitted assets	13,900			13,900
Aggregate write-ins for gains or (losses) in surplus				
Prior years adjustment	764,270			764,270
Net change in capital and surplus	6,754,040		0	6,754,040
Capital and surplus end of reporting period	\$45,208,491		\$0	\$45,208,491

**SURPLUS RECONCILIATION
FOR THE YEARS ENDED DECEMBER 31**

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Capital and Surplus, Prior Reporting Year	\$38,454,451	\$31,712,093	\$31,493,844	\$27,133,980	\$23,834,164
Net income or (loss)	5,975,870	3,790,691	2,578,393	4,886,663	3,294,520
Net unrealized capital gains and losses		109,872	472,651	(539,393)	(8,659)
Change in nonadmitted assets	13,900	2,841,795	(2,857,298)	12,594	13,955
Prior years adjustment	764,270				
Reversal of GAAP allowance for doubtful accounts			24,503		
Net change in capital and surplus	6,754,040	6,742,358	218,249	4,359,864	3,299,816
Capital and Surplus, End of Reporting Period	\$45,208,491	\$38,454,451	\$31,712,093	\$31,493,844	\$27,133,980

NOTES TO THE FINANCIAL STATEMENTS

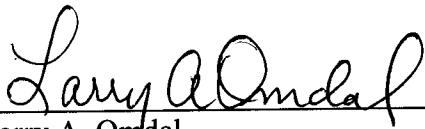
The Company has no special consents, permitted practices or orders from the state of Washington. There were no examination report adjustments.

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of Vision Service Plan during the course of this examination.

In addition to the undersigned, Michael V. Jordan, CPA, CFE, MHP, Assistant Chief Examiner; Carl M. Baker, CPA, CFE, CISA, Supervising Examiner; John Jacobson, AFE, AES, Automated Examination Specialist; Friday P. Enoye, Insurance Examiner, all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,

A handwritten signature in cursive script, reading "Larry A. Omdal", written over a horizontal line.

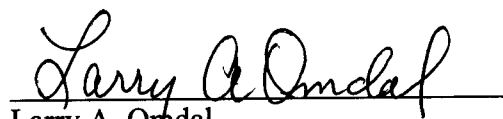
Larry A. Omdal
Examiner-in-Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON }
 }
COUNTY OF KING } **ss**
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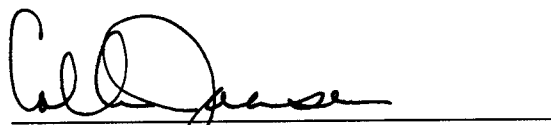
Larry A. Omdal, being duly sworn, deposes and says that the foregoing report subscribed is true to the best of his knowledge and belief.

He attests that the examination of Vision Service Plan was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).



Larry A. Omdal
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me this 25th day of October, 2006.



Notary Public in and for the
State of Washington

